

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

In re  
NINO CAMPANELLA, dba IDA'S  
RESTAURANT,  
Debtor.

Case No. 94-54557-MM

Chapter 11

**MEMORANDUM OPINION AND  
ORDER THEREON**

**INTRODUCTION**

Before the Court for consideration are the following: 1) the debtor's motion to assume its restaurant lease; 2) the debtor's motion for relief from forfeiture under Cal. Code of Civil Procedure § 1179; and 3) landlord Ida Williams' motion for relief from stay. For the following reasons, Campanella's motions are denied, and Williams' motion for relief from stay is granted for cause.

**FACTS**

Nino Campanella filed a chapter 11 petition on July 12, 1994. He operated two restaurants called Ida's: one located in Morgan Hill and the other located in Los Gatos. Campanella contends that the Los Gatos restaurant was operating at a loss and that profits from the Morgan Hill location were diverted to fund the operations of the Los Gatos location. The landlord for the Los Gatos restaurant was granted relief from the automatic stay, and the debtor closed that restaurant during the pendency of the chapter 11 case. Campanella asserts that the profits of the Morgan Hill restaurant are sufficient to meet operating expenses and provide a return to the debtor. At the time Williams filed her motion for relief from stay, Campanella was in default on rent payments for four months.

1 Campanella purchased the restaurant in Morgan Hill from Ida Williams. Although the sale did  
2 not close until March 1992, Campanella took possession of the premises in October 1991. He  
3 executed in September 1991 a ten-year triple net lease with Ida Williams which provided for monthly  
4 rent payments of \$2,740. The written lease provided that the lessee would maintain, repair and  
5 replace the roof and the air conditioning system. Campanella also agreed to execute two promissory  
6 notes in the principal amounts of \$180,000 and \$30,000 for the purchase of the assets of the business  
7 and for the lease of the premises. Among the issues in this proceeding are responsibility for payment  
8 of roof and air conditioning and duct repairs totaling \$13,797.

9 Campanella alleges that prior to closing and while he was in possession of the premises, he  
10 reported to Williams and her representatives that the roof of the restaurant was leaking and in need of  
11 major repair. He contends that a dispute arose in connection with the roof repairs and he declined to  
12 close the sale unless Williams agreed to replace the roof. He also contends that in March 1992,  
13 Williams in fact agreed to replace the roof the following summer if he would pay the note for  
14 \$30,000. To date, the note has not been paid.

15 Campanella contends that the condition of the roof of the restaurant has resulted in periodic  
16 closings of the restaurant, property damage, and substantial lost profits. In April 1994, he filed a suit  
17 in California Superior Court alleging landlord defaults under the lease. Williams also filed a pre-  
18 petition suit on the purchase note and an unlawful detainer action. Pre-petition, Williams purportedly  
19 served a three-day notice to quit on Campanella, which was the third notice in one year. It is  
20 disputed that Campanella received actual notice of the unlawful detainer action. At the Court's  
21 suggestion, Williams filed a notice of removal in Campanella's Superior Court action. Campanella  
22 filed a motion for remand, which is pending and scheduled for hearing on December 1, 1994, because  
23 Campanella has demanded a jury trial.

24 The debtor's cash flow statements in his operating reports are inconsistent with his bank  
25 statements, and Campanella is unable adequately to reconcile the inconsistencies. For example, the  
26 July 1994 operating report reflects an ending cash balance of \$4,391.85, while the bank statements  
27 reflect a beginning cash balance of \$3,139.04 for August 1994. The August operating report reflects  
28 an ending cash balance of \$4,391.85 while the bank statements reflect an ending cash balance of

1 \$1,344.62. The September 1994 operating report reflects an ending cash balance of \$995.82 while  
2 the bank statements reflect an ending cash balance of \$328.51. Operating reports prepared in late  
3 September reflect operating profits of \$674.06 and \$2,444.89 for July and August 1994, respectively.  
4 Revised operating reports also prepared in late September and which include income statements on an  
5 accrual basis reflect operating profits of \$2,601.43, \$3,944.36, and \$5,535.74 for July, August and  
6 September 1994, respectively.

7 The debtor's statement of financial affairs reflects that Campanella received gross (sic) income  
8 from the operation of the two restaurants of \$6,000 and \$4,000 for 1993 and 1992, respectively. He  
9 also scheduled monthly income of \$1,000. Campanella testified that he expects to generate gross  
10 income from operations of \$25,000 to \$30,000 for the month of November and \$45,000 per month  
11 for the next six months. He also testified that he has monthly fixed expenses of \$9,000 to \$9,500.  
12 The debtor realized gross income from operations of \$23,089.30, \$19,526.25, and \$22,822.74 for  
13 July, August and September 1994, respectively. The debtor introduced no evidence of the gross  
14 income figures historically for these months. An evidentiary hearing was held at which the  
15 issues for determination were 1) whether the debtor can provide the landlord with adequate assurance  
16 of future performance and 2) whether there are other existing defaults under the lease. To determine  
17 whether there are any other defaults under the lease, the court must decide whether the debtor is  
18 responsible for the roof repairs and air conditioning and duct repairs pursuant to the lease as modified  
19 in March 1992.

## 20 DISCUSSION

### 21 A. Adequate Assurance of Future Performance

22 Section 365(b)(1) provides in pertinent part:

23 If there has been a default in an executory contract or unexpired  
24 lease . . . , the trustee may not assume such contract or lease unless  
. . . the trustee --

25 (A) cures, or provides adequate assurance that the trustee will  
26 promptly cure, such default;

\* \* \*

27 (C) provides adequate assurance of future performance under  
28 such contract or lease.

Campanella asserts that he is able to cure all monetary defaults under the lease. At issue is whether the debtor has the ability to provide adequate assurance of future performance under the lease as contemplated by § 365(b)(1)(C). The debtor bears the burden of proof on whether it has furnished adequate assurance of future performance. In re Rachel's Industries, Inc., 109 B.R. 797, 802 (Bankr. W.D. Tenn. 1990).

What constitutes adequate assurance of future performance is determined on a case by case basis. 2 Collier on Bankruptcy ¶ 365.04[1] (15th ed. 1993). Under § 365(b)(1), adequate assurance that certain action will be taken serves as a substitute for the action itself. Id. The chief determinant of adequate assurance of future performance is whether rent will be paid. In re Bygaph, Inc., 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986). The factors for the court to consider to determine whether the debtor will be able to provide adequate assurance include the present status of the debtor's obligations under the lease, the remaining lease term, the prospects for reorganization, and what the landlord can look to for sufficient adequate assurance of future performance. In re Hub of Military Circle, Inc., 19 B.R. 460, 461 (Bankr. E.D. Va. 1982).

The best form of adequate assurance of future performance is advance rent or a deposit. In re Hub of Military Circle, Inc., 19 B.R. at 461. However, it may also include sufficient financial backing, escrow deposits or other similar forms of security or guaranty, or even promises, In re Gold Standard at Penn, Inc., 75 B.R. 669, 674 (Bankr. E.D. Pa. 1987), sound financial statements and a substantial net worth, In re Taylor Manufacturing, Inc., 6 B.R. 370, 372 (Bankr. N.D. Ga. 1980), projected sales proceeds sufficient for and earmarked for payment of rent, Buchakian v. Musikahn Corp., 69 B.R. 55, 56 (E.D.N.Y. 1986), a substantial cash reserve, a favorable market outlook and the history of prompt payment, Seacoast Products, Inc. v. Spring Valley Farms, Inc., 34 B.R. 379, 381 (M.D.N.C. 1983), or granting a security interest securing damages for the subsequent breach of a lease, In re Multech Corp., 47 B.R. 747, 753 (Bankr. N.D. Iowa 1985).

On the other hand, in circumstances in which the debtor has not provided sufficient adequate assurance of future performance under § 365(b)(1), the court may decline to approve the debtor's assumption of the continued burden of a lease based on the obligations imposed by §

365(b)(1). Examples of the failure to satisfy the requirement of adequate assurance of future performance include a declaration in support of assumption of executory contracts and leases in which the debtor stated that he recognized the ongoing obligation to maintain certain leases, Sea Harvest Corp. v. Riviera Land Co., 868 F.2d 1077, 1080 (9th Cir. 1989), a brief compilation that does not conform to generally accepted accounting principles as the only evidence presented on the financial condition of the debtor's principal, In re Washington Capital Aviation & Leasing, 156 B.R. 167, 175 (Bankr. E.D. Va. 1993), debtor's failure to establish availability of cash, debtor's current financial condition, and precarious past performance, In re World Skating Center, Inc., 100 B.R. 147, 148-49 (Bankr. D. Conn. 1989), and a lack of profitability over the term of the bankruptcy case and an absence of a sufficient likelihood of profitability as reflected by the debtor's financial statements, In re Berkshire Chemical Haulers, Inc., 20 B.R. 454, 458-59 (Bankr. D. Mass. 1982).

A review of the facts in this case leads to the conclusion that the debtor has not satisfied his burden to provide adequate assurance of future performance under the lease. The factors that are of particular significance to the court's determination are the debtor's history of multiple defaults under this lease, the marginal income derived from the operations of the restaurant, and the unexplained inconsistencies between the debtor's operating statements and bank statements. Under cross-examination, the debtor's testimony was inadequate to explain the basis for the inconsistencies. The debtor was unable to provide adequate forecasts of his restaurant operations. The evidence presented either was not reliable or failed to make sense. It does not appear likely that the restaurant's operations can generate sufficient income to meet operating expenses, provide adequate assurance, and pay for the debtor's and his family's living expenses.

#### **B. Other Defaults Under Lease**

Defaults on the contractual obligations under a lease, such as failure to pay accrued and delinquent personal property taxes and failure to make necessary repairs and perform necessary maintenance, must also be cured prior to assumption, or the debtor must provide adequate assurance of prompt cure. In re Rachels Industries, Inc., 109 B.R. at 811-12.

In support of her position that the parties did not enter a separate agreement regarding the

1 roof repairs, Williams argues that the parol evidence rule precludes the introduction of evidence  
2 regarding a separate agreement pursuant to an integration clause in the lease which requires that  
3 all modifications be in writing. The court reserved the issue for later ruling.

4 Cal. C.C.P. § 1856(a) provides:

5 Terms set forth in a writing intended by the parties as a final  
6 expression of their agreement with respect to such terms as are  
7 included therein may not be contradicted by evidence of any prior  
8 agreement or of a contemporaneous oral agreement.

9 However, there are exceptions to the parol evidence rule. For example, the parol evidence rule  
10 does not bar extrinsic evidence that shows that the parties subsequently modified their integrated  
11 writing. Beggerley v. Gbur, 112 Cal. App. 3d 180, 188, 169 Cal. Rptr. 166, 170 (Cal. App.  
12 1980).

13 With respect to the requirement that modifications be written, any provision in a lease may  
14 be waived by conduct. See Bettelheim v. Hagstrom Food Stores, 113 Cal. App. 2d 873, 878  
15 (Cal. App. 1952)(although lease provided that waiver must be in writing, landlord waived penalty  
16 for holding over by accepting customary rent without objecting).

17 The Court received extensive testimony from both the debtor and from Williams regarding  
18 their negotiations for liability on roof repairs. John Dossetti, a real estate agent who negotiated  
19 the sale of the restaurant to Campanella, also testified that the parties reached a verbal agreement  
20 that Williams would replace the roof if Campanella would pay the \$30,000 note. Although the  
21 court found the testimony of both parties and of Mr. Dossetti to be credible, the court need not  
22 make a determination of liability for the roof repairs. The finding that the debtor has not furnished  
23 the landlord with adequate assurance of future performance obviates the need to make a  
24 determination on the issue of other defaults on the contractual obligations under the lease.

### 25 **C. Relief From Forfeiture**

26 A court may relieve a tenant from the forfeiture of a lease and restore the lessee to the  
27 former estate under Cal. C.C.P. § 1179 in the case of hardship. For the debtor to be entitled to  
28 relief from forfeiture, however, the lessee must furnish full payment of all rent due and complete  
performance of all conditions and covenants of the lease. The inquiry under § 1179 is generally

1 an equitable one, in which the court balances the equities and hardship upon the lessee and the  
2 lessor. Thrifty Oil Co. v. Batarse, 174 Cal. App. 3d 770, 777, 220 Cal. Rptr. 285 (1985).

3 In view that the court is denying the debtor's request to assume the restaurant lease on the  
4 basis that he has failed to provide the landlord adequate assurance of future performance under  
5 the lease, relief from forfeiture would be inappropriate, and the issue is moot.

6 **D. Relief From Stay Is Appropriate**

7 Because the debtor's motion to assume the restaurant is denied, relief from the stay for  
8 cause appears appropriate. See In re Future Growth Enterprises, Inc., 61 B.R. 469, 472 (Bankr.  
9 E.D. Pa. 1986)(denial of debtor's motion to assume lease is cause for motion for relief from stay).

10 **CONCLUSION**

11 The debtor's motions to assume the lease and for relief from forfeiture are denied. Ida  
12 Williams' motion for relief from stay to proceed with an action in Superior Court for unlawful  
13 detainer and to determine the debtor's liability on other lease obligations is granted for cause.

14 Good cause appearing, it is SO ORDERED.  
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